CORPORATE FINANCE LAW IN THE UK AND EU

Edited by
DAN PRENTICE
ARAD REISBERG

OXFORD UNIVERSITY PRESS
SUMMARY CONTENTS

Table of Cases xxvi
Table of Legislation xxxiii
List of Contributors xlv
List of Abbreviations li

PART I EQUITY FINANCING AND CAPITAL MARKETS FINANCE

1. The Prohibition Against Financial Assistance: Constructing a Rational Response 3
   John Lowry

2. The Decline of Legal Capital: An Exploration of the Consequences of Board Solvency-Based Capital Reductions 27
   David Kershaw

3. Schemes of Arrangement 59
   Ceri Bryant

4. Insider Dealing After the Market Abuse Directive 87
   Jesper Lau Hansen

5. Short-Sales Regulation in Seasoned Equity Offerings: What Are the Issues? 117
   Emilios Avgouleas

6. Initial Public Offers—The Supply and Demand Side Perspectives in the Legal Framework 139
   Iris H-Y Chiu

7. The Future Role of Credit Rating Agencies in Contemporary Financial Markets—A Theoretical Perspective 169
   Arad Reisberg

PART II DEBT FINANCING AND TAXATION

8. Contractual Aspects of Debt Financing 213
   Robert Stevens
<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Author(s)</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>9.</td>
<td>Security</td>
<td>Marcus Smith QC</td>
<td>233</td>
</tr>
<tr>
<td>10.</td>
<td>Set-off, Netting, and Alternatives to Security</td>
<td>Ian Annetts and Edward Murray</td>
<td>269</td>
</tr>
<tr>
<td>11.</td>
<td>Policy Issues and Reform in Debt Finance: The Reform of the</td>
<td>Andrew McKnight</td>
<td>295</td>
</tr>
<tr>
<td></td>
<td>English Law of Secured Transactions in Personal Property</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>England</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13.</td>
<td>The Assymetrical Treatment of Debt and Equity Finance</td>
<td>John Vella</td>
<td>361</td>
</tr>
<tr>
<td></td>
<td>under UK Tax Law</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Corporate Finance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15.</td>
<td>How Does Corporate Mobility Affect Lawmaking?</td>
<td>William W Bratton, Joseph A McCabery, and Erik P M Vermeulen</td>
<td>429</td>
</tr>
<tr>
<td></td>
<td>Company Law</td>
<td></td>
<td></td>
</tr>
<tr>
<td>17.</td>
<td>Equivalence-Based Regulation and EU Prospectus Law—The Shadow</td>
<td>Pierre Schammo</td>
<td>493</td>
</tr>
<tr>
<td></td>
<td>Regime</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18.</td>
<td>Legal Capital and the EU Treaties</td>
<td>Heribert Hirte and Alexander Schall</td>
<td>519</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>PART III EUROPEAN LAW AND POLICY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Corporate Finance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15.</td>
<td>How Does Corporate Mobility Affect Lawmaking?</td>
<td>William W Bratton, Joseph A McCabery, and Erik P M Vermeulen</td>
<td>429</td>
</tr>
<tr>
<td></td>
<td>Company Law</td>
<td></td>
<td></td>
</tr>
<tr>
<td>17.</td>
<td>Equivalence-Based Regulation and EU Prospectus Law—The Shadow</td>
<td>Pierre Schammo</td>
<td>493</td>
</tr>
<tr>
<td></td>
<td>Regime</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18.</td>
<td>Legal Capital and the EU Treaties</td>
<td>Heribert Hirte and Alexander Schall</td>
<td>519</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Index</strong></td>
<td></td>
<td>541</td>
</tr>
</tbody>
</table>
## CONTENTS

| Table of Cases                      | xxi |
| Table of Legislation               | xxxiii |
| List of Contributors               | xlv |
| List of Abbreviations              | li |

## PART I EQUITY FINANCING AND CAPITAL MARKETS FINANCE

1. **The Prohibition Against Financial Assistance: Constructing a Rational Response**
   - 1.1 Introduction 3
   - 1.2 The Origins, Development, and Policy Objectives of the Prohibition 6
   - 1.3 The Current Regime
     - 1.3.1 Background 13
     - 1.3.2 The meaning of financial assistance 14
     - 1.3.3 The exceptions to the prohibition 16
     - 1.3.4 The consequences of breaching the prohibition 18
     - 1.3.5 Towards relaxing the prohibition: EU developments 21
   - 1.4 Constructing a Measured Response to Financial Assistance 22
   - 1.5 Conclusion 24

2. **The Decline of Legal Capital: An Exploration of the Consequences of Board Solvency-Based Capital Reductions**
   - 2.1 Introduction 27
   - 2.2 Legal Strategies for Regulating Capital 35
   - 2.3 The Winners and Losers from the Board-Solvency-Statement Option 41
   - 2.4 The Irrelevance of Capital-Reduction Regulation 47
   - 2.5 The Evolutionary Implications of Legal Capital Reform 52
   - 2.6 Conclusion 56

3. **Schemes of Arrangement**
   - 3.1 Introduction 59
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.11.4</td>
<td>The role of the Takeover Panel</td>
<td>82</td>
</tr>
<tr>
<td>3.12</td>
<td>The Scheme Process</td>
<td>83</td>
</tr>
<tr>
<td>3.12.1</td>
<td>Electronic communications and use of websites</td>
<td>83</td>
</tr>
<tr>
<td>3.12.2</td>
<td>Conduct of the meetings</td>
<td>84</td>
</tr>
<tr>
<td>3.12.3</td>
<td>Factors to be taken into account when the court exercises discretion to sanction a scheme</td>
<td>85</td>
</tr>
<tr>
<td>3.12.4</td>
<td>Collateral motives for voting</td>
<td>86</td>
</tr>
<tr>
<td>4.1</td>
<td>Introduction</td>
<td>87</td>
</tr>
<tr>
<td>4.2</td>
<td>Criticism and Justification of the Ban</td>
<td>88</td>
</tr>
<tr>
<td>4.3</td>
<td>Inside Information</td>
<td>91</td>
</tr>
<tr>
<td>4.4</td>
<td>Abuse of Inside Information</td>
<td>97</td>
</tr>
<tr>
<td>4.5</td>
<td>The Necessary <em>Mens Rea</em> and Other Requirements of Due Process in Insider Dealing Cases</td>
<td>100</td>
</tr>
<tr>
<td>4.6</td>
<td>Legal Transactions</td>
<td>104</td>
</tr>
<tr>
<td>4.6.1</td>
<td>No use of the inside information</td>
<td>104</td>
</tr>
<tr>
<td>4.6.2</td>
<td>Equal use</td>
<td>106</td>
</tr>
<tr>
<td>4.6.3</td>
<td>Fair use</td>
<td>107</td>
</tr>
<tr>
<td>4.6.4</td>
<td>The presumption of use and its rebuttal</td>
<td>110</td>
</tr>
<tr>
<td>4.7</td>
<td>Passing on Inside Information</td>
<td>112</td>
</tr>
<tr>
<td>4.8</td>
<td>Conclusion</td>
<td>116</td>
</tr>
<tr>
<td>5.1</td>
<td>Introduction</td>
<td>117</td>
</tr>
<tr>
<td>5.2</td>
<td>Short-Sales in Contemporary Financial Markets</td>
<td>121</td>
</tr>
<tr>
<td>5.3</td>
<td>Should Short-Sales in the Context of SEOs be Banned? A Cost-Benefit Analysis</td>
<td>125</td>
</tr>
<tr>
<td>5.3.1</td>
<td>The efficiency benefits of short-selling</td>
<td>125</td>
</tr>
<tr>
<td>5.3.2</td>
<td>Destabilization of orderly markets and settlement risk</td>
<td>127</td>
</tr>
<tr>
<td>5.3.3</td>
<td>The impact of short-sales on SEOs</td>
<td>128</td>
</tr>
<tr>
<td>5.3.4</td>
<td>Does short-selling before SEOs amount to market abuse?</td>
<td>131</td>
</tr>
<tr>
<td>5.4</td>
<td>How Short-Sales in the Context of SEOs Should be Regulated</td>
<td>133</td>
</tr>
<tr>
<td>5.4.1</td>
<td>IOSCO Principles</td>
<td>133</td>
</tr>
<tr>
<td>5.4.2</td>
<td>EU proposals</td>
<td>134</td>
</tr>
<tr>
<td>5.4.3</td>
<td>A model for the regulation of short-selling around SEOs</td>
<td>135</td>
</tr>
<tr>
<td>5.5</td>
<td>Conclusion</td>
<td>138</td>
</tr>
</tbody>
</table>
6. Initial Public Offers—the Supply and Demand Side Perspectives in the Legal Framework

6.1 Introduction

6.2 The Supply Side Perspective
   6.2.1 The prospectus passport in the EU
   6.2.2 Cognizance for industry needs in the regulation of offer documents
   6.2.3 Little regulation of the bookbuilding process
   6.2.4 The exception of price stabilization
   6.2.5 The exceptions to the prospectus regime

6.3 The Demand Side Perspective
   6.3.1 The disclosure regime and investor protection
   6.3.2 Market trends, practices, and biases surrounding an IPO
   6.3.3 Investor redress

6.4 Conclusion

7. The Future Role of Credit Rating Agencies in Contemporary Financial Markets—A Theoretical Perspective

7.1 Introduction

7.2 The Role of CRAs, their Potential Liability, and the Various Flaws in their Operation
   7.2.1 Defining credit ratings
   7.2.2 Credit ratings: just an opinion?
   7.2.3 Distinguishing CRAs from other rating agencies
   7.2.4 The use of ratings made by market participants
   7.2.5 The criticisms advanced against CRAs

7.3 The Relationship between CRAs and the Structured Finance Market
   7.3.1 Asset securitization
   7.3.2 Collateralized debt obligations

7.4 Regulating CRAs and Assessment of Current Proposals for Reform
   7.4.1 Is more regulation needed?
   7.4.2 Financial Stability Forum
   7.4.3 SIFMA
   7.4.4 The EU Regulation on CRA
   7.4.5 The Turner Review in the UK

7.5 Conclusion

PART II DEBT FINANCING AND TAXATION

8. Contractual Aspects of Debt Financing

8.1 Introduction
8.2 Contract and Conveyance 213
8.3 Characterization as a Charge 218
8.4 The Mystery of the Floating Charge 219
8.5 Failure to Insist Upon Contractual Rights 223
8.6 Automatic Crystallization 226
8.7 Charge Backs 227
8.8 The 'Two Funds' Fallacy 229
8.9 Conclusion 231

9. Security 233

9.1 Overview 233
9.2 Types of Security 234
  9.2.1 Pledge 235
  9.2.2 Lien 239
  9.2.3 Mortgage 240
  9.2.4 The charge 243
9.3 Classification and Characterization 245
  9.3.1 The English law approach to classification 245
  9.3.2 Difficult questions in the classification of securities 248
9.4 Security over Intangibles and Future Assets 252
  9.4.1 The manner in which securities are held and dealt with 252
9.5 Security and the Need to Deal with Assets 255
9.6 The Problem of Charge Backs 257
9.7 Presenting a 'True and Fair View': Registration 258
  9.7.1 The importance of registration 258
  9.7.2 The English registration regime 258
  9.7.3 Foreign corporations 260
  9.7.4 Registration under the Companies Act and the specialist registers 261
9.8 Priorities 262
  9.8.1 The different priority rules 262

10. Set-off, Netting, and Alternatives to Security 269
10.1 Introduction 269
10.2 Set-off 271
10.3 Netting 277
10.4 Alternatives to Security 281
10.5 European Law 290
11. Policy Issues and Reform in Debt Finance: The Reform of the English Law of Secured Transactions in Personal Property

11.1 Introduction

11.2 Examining the Case for Reform
   11.2.1 The multiplicity of interests and forms of transaction under English law
   11.2.2 Fixed vs floating charges
   11.2.3 Security vs other transactions: the risk of re-characterization and the difficulties with rights and remedies
   11.2.4 Registration of security
   11.2.5 Priorities

11.3 Previous Suggestions for Reform

11.4 The Current Consultation

11.5 Suggestions for Reform

11.6 Further Questions for Consideration


12.1 Introduction

12.2 The Material, Personal, and Temporal Scope of the FCAR

12.3 Financial Collateral
   12.3.1 Cash
   12.3.2 Financial instruments

12.4 Security Financial Collateral Arrangement
   12.4.1 Relevant financial obligations
   12.4.2 Possession and control

12.5 Title Transfer Financial Collateral Arrangement

12.6 Disapplication of Formalities

12.7 Disapplication of Insolvency Provisions

12.8 Close-out Netting

12.9 Right of Use Under Security Financial Collateral Arrangement

12.10 Enforcement by Way of Appropriation

12.11 Conflict of Laws Regarding Book Entry Securities Collateral

12.12 Conclusion
Contents

13. The Assymetrical Treatment of Debt and Equity Finance under UK Tax Law 361

13.1 Introduction 361
13.2 Debt and Equity Finance under UK Tax Law 363
13.3 Is the Different Tax Treatment of Debt and Equity Justified? 365
13.4 Does the Difference in Treatment Affect the Capital Structure of Companies? 368
13.5 Behavioural Responses and Legislative Rejoinder 369
   13.5.1 Equity disguised as debt 370
   13.5.2 Debt disguised as equity 374
13.6 International Tax Issues 376
   13.6.1 Thin capitalization rules 377
   13.6.2 Taxation of foreign profits, debt cap, and controlled foreign companies 381
   13.6.3 International tax arbitrage 386
13.7 Conclusion 389

PART III EUROPEAN LAW AND POLICY

14. The EU Financial Services Action Plan and its Impact on Corporate Finance 393

14.1 Introduction 393
14.2 Setting the Scene 397
   14.2.1 The single market programme 397
   14.2.2 What is the FSAP? 398
   14.2.3 The Lamfalussy lawmaking process 399
14.3 Assessing the Impact of the FSAP on EU Corporate Finance 401
   14.3.1 Regulatory impacts: establishing the contours of the new regulatory landscape 403
   14.3.2 Market impacts 410
   14.3.3 Elements of regulatory competition 417
   14.3.4 Costs and inefficiencies 419
14.4 Conclusion 425

15. How does Corporate Mobility Affect Lawmaking? A Comparative Analysis 429

15.1 Introduction 429
15.2 Challenging the 'Non-Competition' Strategy?:
   The Societas Europaea
      15.2.1 The SE: an incomplete lawmaking product
      15.2.2 The SE: a vehicle for company law arbitrage?
15.3 ECJ Case Law: Challenging the 'Non-Competition' Strategy?
      15.3.1 The incorporation mobility cases
      15.3.2 The reincorporation mobility cases
      15.3.3 The practical impact of the ECJ case law
      15.3.4 Responsive (but not competitive) lawmaking in Germany
           and the Netherlands
15.4 Conclusion

   16.1 Introduction
   16.2 Freedom of Establishment and Free Movement of Capital
   16.3 The Volkswagen Case
      16.3.1 Background
      16.3.2 The judgment
      16.3.3 The Thyssen Krupp case
      16.3.4 Consequences and emerging questions
   16.4 Systematic Analysis of the Free Movement of Capital
      16.4.1 Private action
      16.4.2 State action
      16.4.3 A common approach
      16.4.4 Volkswagen: the aftermath
   16.5 Conclusion

17. Equivalence-Based Regulation and EU Prospectus Law—The Shadow Regime
   17.1 Introduction
   17.2 Equivalence-Based Regulation and Article 20 PD
      17.2.1 Prior approval as a means to recognize equivalence
      17.2.2 Limits to prior approval
      17.2.3 Equivalence-based regulation among Member States
   17.3 Article 20 PD: A Shadow Regime in Need of Reform?
      17.3.1 Pathology
      17.3.2 Remedies
      17.3.3 Strategies
      17.3.4 Actors
   17.4 Conclusion
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>18 Legal Capital and the EU Treaties</td>
<td>519</td>
</tr>
<tr>
<td>18.1 Introduction</td>
<td>519</td>
</tr>
<tr>
<td>18.2 Summary of the (Former) Debate on Legal Capital</td>
<td>520</td>
</tr>
<tr>
<td>18.3 The Test of Legal Capital under EU Law</td>
<td>527</td>
</tr>
<tr>
<td>18.3.1 National provisions on legal capital and basic freedoms</td>
<td>527</td>
</tr>
<tr>
<td>18.3.2 Directive provisions on minimum capital and basic freedoms</td>
<td>534</td>
</tr>
<tr>
<td>18.3.3 The legal capital system of the Directive: legitimate harmonization?</td>
<td>537</td>
</tr>
<tr>
<td>18.4 Conclusion</td>
<td>539</td>
</tr>
</tbody>
</table>

Index 541